The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE
1401 H Street, NW, Washington, DC 20005 USA

March 10, 2025

Mr. Leader Moon:
350 Taylor House Office Building
6 Bladen Street
Annapolis, MD 21401

Senator Hettleman
220 James Senate Office Building
11 Bladen Street
Annapolis, MD 21401

Delegate Vanessa Atterbeary, Chair
Delegate Jheanelle Wilkins, Vice Chair
Ways and Means Committee
House Office Building, Room 130,
Annapolis, MD

Senator Guy Guzzone, Chair
Senator Jim Rosapepe, Vice Chair
Budget and Taxation Committee
West Miller Senate Building, Room 3,
Annapolis, MD

Re: *SB 1045 & HB 1554: Sales Tax on Additional Services - Oppose*

Dear Mr. Leader Moon and Senator Hettleman,

The Investment Company Institute (ICI)[1]—on behalf of its members (asset managers) that operate or do business in Maryland, and all Maryland residents who save and invest through funds—strongly opposes SB 1045 and HB 1554, which expands the sales tax on services to additional services.

[1] The Investment Company Institute (ICI) is the leading association representing the asset management industry in service of individual investors. ICI's members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in other jurisdictions. Its members manage $39.1 trillion invested in funds registered under the US Investment Company Act of 1940, serving more than 120 million investors. Members manage an additional $9.6 trillion in regulated fund assets managed outside the United States. ICI also represents its members in their capacity as investment advisers to collective investment trusts (CITs) and retail separately managed accounts (SMAs). ICI has offices in Washington DC, Brussels, and London.

Executive Summary

The proposed amendment to Section 11–101(c–12)(m)(14) would expand the definition of taxable services to include many financial services,[2] including investment advice and asset management services, among other services. We oppose these changes on three grounds:

- First, sales tax should not be applied to or incurred by shareholders and other investors saving for retirement and other important financial goals.
- Second, asset managers in Maryland should not be placed at a competitive disadvantage to out-of-state competitors.
- Third, applying sales tax to asset management services would be extraordinarily difficult (if not impossible) to implement and administer efficiently and fairly.

ICI strongly recommends that the sales tax not be extended to financial services including asset management services. At a minimum, a comprehensive study must be conducted to avoid unintended consequences of a services tax on the asset management industry.

1. Background on Investment Funds, Shareholders, and Asset Managers

An investment fund pools individual investors' collective savings and invests in a diversified portfolio of stocks, bonds or other securities. Each fund investor is a shareholder of the fund. Each share represents a proportionate ownership in all the fund's underlying securities. Investment securities are selected by a professional investment adviser to meet a specific financial goal, such as growth or income. The fund selects an investment adviser (also called an "asset manager" or "manager") to manage the fund's assets, operate and administer the fund. These investment advisers may also hire other investment advisers to manage portions of the fund, or the entire fund, or to provide specific investment advice ("sub-advisors").

Funds typically are distributed nationally. Investors often purchase their shares through intermediaries (*e.g.,* brokers) rather than directly from the fund. Shares purchased through an intermediary often are registered with the fund in the intermediary's name in a so-called "street name" account. Funds often will have little or no information about the intermediary's customers holding through these accounts. This information typically can be procured from third parties; this information, however, is neither immediately available, nor free.

Funds with a common investment adviser are often referred to as a fund "family" or "complex." Competition between fund complexes and their advisers is intense. This competition has led to a steep drop in fees that managers charge for investment advisory services.[3] As a result, managers are increasingly sensitive to state and local taxes that may place them at a competitive disadvantage.

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[2] As defined by reference to NAICs code 5239 (Other financial investment activities). https://www.naics.com/naics-code-description/?v=2017&code=5239.

[3] Asset-weighted average expense ratios for equity, bond, and hybrid mutual funds fell in 2018 to their lowest levels in at least 25 years. For example, asset-weighted basis, average expense ratios for equity mutual funds fell from 0.99 percent in 2000 to 0.42 percent in 2023, a 58 percent decline. https://www.icifactbook.org/pdf/2024-factbook-ch6.pdf

2. Sales tax should not be applied to or incurred by shareholders and other investors saving for retirement and other important financial goals.

Imposing sales tax on the investment advisory services provided to funds and their shareholders will increase the cost of saving for retirement and other long-term needs. Given the increased responsibility that individuals have for ensuring their own retirement security, the legislature should be creating incentives to *encourage* rather than *discourage* saving.

Mutual funds and exchange traded finds (ETFs) are the investment vehicle of choice for moderate-income investors, have democratized our capital markets in ways that could not have been imagined just a generation or two ago. The typical mutual fund investor is a middle-class American with a median household income of $100,000 and modest holdings.[4] More than half of all American households are mutual fund investors and now depend on these investments to buy a home, finance a child's education, support aging parents or extended family, and prepare for retirement. Sales tax paid by the investment advisor is effectively incurred by the fund's shareholders, as taxes and fees paid by the fund directly reduce the value of the fund, and every share of that fund.

3. Asset managers in Maryland should not be placed at a competitive disadvantage to out-of-state competitors.

Extending the sales tax to services provided by asset managers operating in Maryland could place them at a distinct competitive disadvantage with out-of-state asset managers. Asset managers and their employees are mobile, and their offices are dispersed through the United States and overseas. These are well-compensated jobs and highly educated employees that states often covet. The legislature should be incentivizing asset managers to locate, hire, and operate in Maryland, rather than elsewhere. Asset managers remaining in Maryland likely would be required to assess and collect sales tax on their services, while out-of-state asset managers may not, or may incur less Maryland sales tax. Imposing sales tax on services *always* have this anti-competitive effect for Maryland-based asset managers, it cannot be corrected by technical modifications to the legislation.

Asset managers need well-educated employees and ready access to modern technology. Physical equipment requirements are minimal. The growing prevalence of remote work in the post-pandemic hybrid working environment, and advances in technology, have further decreased the need for asset managers to maintain office space. Many employers are downsizing office space and reducing or eliminating hiring in states that create significant tax burdens for companies operating in those states, such as sales taxes on services. These employers will simply hire employees in other states where they have offices or hire remote employees in states with more favorable tax regimes. Likewise, fund shareholders are widely dispersed across the United States, and can easily communicate with an asset manager electronically, by mail, or over the phone. A "local" asset manager has no inherent advantage over "non-local" managers in attracting new local investors. Given this mobility of asset managers and shareholders, other factors such as tax burdens provide a strong incentive or

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[4] The median mutual fund–owning household had $100,000 in household income, $225,000 in household financial assets, and $125,000 invested in three mutual funds, including at least one equity mutual fund. https://www.icifactbook.org/pdf/2024-factbook-ch7.pdf

disincentive for asset managers when determining where to establish or expand operations and hire or relocate employees.

4. **Third, applying sales tax to asset management services would be extraordinarily difficult (if not impossible) to implement and administer efficiently and fairly.**

The bill as drafted applies broadly to all investment advice but does not specify how the tax would be applied to the fund industry. Difficult policy questions arise in determining, for example, which party (the investment adviser, the fund, or the investors) should be treated as receiving the service. Careful study is needed before enacting taxes with highly uncertain application.

If investment advice was subject to tax, it isn't clear what portion of investment advisory services (if any) would taxable in Maryland. The fund itself contracts with the investment adviser for their services, but is isn't clear whether the fund or the fund's shareholders ultimately benefit from those services. Sub-advised funds present additional complexity, because the fund's investment adviser may sub-contract with other investment advisers to manage a portion of the fund.

A sales tax on services *theoretically* could be assessed either against the fund itself or against the fund's shareholders. Presumably, the tax would be assessed based upon the location of (1) the fund's assets manager, or (2) the fund's state of incorporation, if the fund were treated as the consumer, or (3) the fund's shareholders, if the shareholders were treated as the consumer on a look-through basis. If the fund's investors are deemed to be the consumer of these services, it would be difficult or impossible to determine the location of all fund shareholders. Many individuals invest in funds through brokers and other intermediaries, which do not disclose the identities or residences of their customers to the fund or the fund's investment advisor.

Collection would be problematic if the tax were applied broadly to funds with no presence in Maryland that have shareholders in Maryland. Out-of-state asset managers and funds would not know how many of their investors were Maryland residents and what tax would be assessed and potentially due. Easily-collectible tax might be limited to those Maryland investors who purchase fund shares directly from managers with operations in Maryland. This result would be bad for Maryland because it would disadvantage fund managers operating in Maryland compared to fund managers located elsewhere.

If the location of the sale was determined based on the location of the fund's asset manager (or where it has employees), or the fund's state of incorporation, the tax would apply only to funds incorporated in or managed by asset managers with operations in Maryland and would be based upon the full cost of the service. This would increase expenses of funds managed from or operating in Maryland and would put these funds and their asset managers at a distinct competitive disadvantage both in the US market and globally.

If the location of the sale was determined based on the location of the fund's investors (shareholders), the tax could theoretically be charged to all funds regardless of whether they were managed or operated in Maryland or elsewhere, based on the portion of each fund's shareholders based in Maryland. Three problems would arise from this approach.

First, significant difficulties arise in collecting tax from fund managers located outside of Maryland. Second, as described above, fund managers often do not know their shareholders' states of residence. Determining residence would result in additional costs—all of which would be borne by the funds' shareholders. Third, even if the tax could be charged to and collected from asset managers nationwide, based on the shareholder location, the tax would not be borne only by the funds' Maryland shareholders. Funds cannot allocate expenses to specific shareholders based upon residence or any other criteria (other than share class). Although the tax might be "charged" for services "provided" in Maryland, the tax burden would fall equally on all investors, wherever they reside.

Finally, sales tax on business-to-business transactions are harmful and can result in multiple cascading taxation of the same revenue without appropriate exemptions. ICI opposes sales taxes on business-to-business transactions, for the same reason described by COST, in the attached comment letter, which may be revised and resubmitted by COST. ICI won't duplicate those comments here but will raise one additional point about the duplicative nature of business-to-business taxes in the asset management industry. Many funds are sub-advised, which means that the fund contracts with and pays a primary asset manager, who then separately contracts with and pays a secondary asset manager (sub-advisor) to manage a portion of the portfolio. A single fund can have multiple sub-advisors, and a sub-advisor can also contract with additional sub-advisors (sub-sub-advisors). In these scenarios, a single asset management fee could be taxed multiple times, compounding the tax burden that is ultimately borne by the fund's shareholders. Similar duplicative taxation could apply to transaction between affiliates of the asset manager.

In closing, we oppose the proposed expansion of sales tax to asset management services and other financial services.

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The ICI appreciates your consideration of our concerns. Please do not hesitate to contact Mike Horn at michael.horn@ici.org or (202) 326-5832 or Katie Sunderland at katie.sunderland@ici.org or (202) 326-5826 if you have any questions regarding this letter or would like any additional information regarding the organization, operation, or taxation of funds and their shareholders.

Sincerely,

Mike Horn

Mike Horn

Deputy General Counsel - Tax Law

Katie Sunderland

Katie Sunderland

Associate General Counsel – Tax Law

cc:

Speaker of the House Adrienne A. Jones
H-101 State House
100 State Circle
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Senate President Bill Ferguson
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COST
COUNCIL ON STATE TAXATION

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March 2, 2020

Maryland General Assembly
House Ways and Means Committee

Re: COST's Opposition to House Bill 1628, Sales and Use Tax – Rate Reduction and Services

Dear Chair Kaiser, Vice Chair Washington, and Members of the Committee:

Thank you for the opportunity to provide testimony today on behalf of the Council On State Taxation (COST) in opposition to House Bill 1628 (H.B. 1628), Sales and Use Tax – Rate Reduction and Services, which would inappropriately expand the application of Maryland's sales tax to many business inputs without an exemption for business-to-business transactions. Business inputs constitute intermediate, not final, goods and services because companies either resell these goods and services or use the materials, products, machinery and services to produce other goods or services that subsequently are sold to households.

COST does not generally oppose legislation that broadens a state's sales tax base to business-to-*consumer* transactions. However, H.B. 1628's proposed sales tax expansion to include services—many of which are predominantly provided to businesses, without providing an exemption for business inputs—directly violates the economic principle that an ideal sales tax should tax household consumption and not business inputs.[1]

If this legislation passes, Maryland would be the first state in decades—and the only large population state ever—to impose such an expansive sales tax on business inputs. There are only a few smaller-population and non-industrialized states that long ago enacted a broad-based sales tax on services ((*e.g.*, South Dakota, Hawaii, and New

[1] *See* Andrew Phillips and Muath Ibaid, Ernst & Young LLP, "The Impact of Imposing Sales Taxes on Business Inputs," prepared for the State Tax Research Institute and the Council On State Taxation (May 2019), available at: https://www.cost.org/globalassets/cost/stri/studies-and-reports/1903-3073001_cost-ey-sales-tax-on-business-inputs-study_final-5-16.pdf; John L. Mikesell, "Reversing 85 Years of Bad State Retail Sales Tax Policy," State Tax Notes (February 4, 2019); Robert Cline, Andrew Phillips and Tom Neubig, Ernst & Young LLP, "What's Wrong with Taxing Business Services? Adverse Effects from Existing and Proposed Sales Taxation of Business Investment and Services," prepared for the Council On State Taxation (April 4, 2013), available at: https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/sales-taxation-of-services-and-business-inputs-study.pdf; Analysis of Proposed Changes to Select Ohio Taxes Included in the Ohio Executive Budget and Ohio House Bill Number 64, issued in 2015, available at: https://cost.org/globalassets/cost/stri/studies-and-reports/analysis-of-proposed-changes-to-select-ohio-taxes-included-in-the-ohio-executive-budget.pdf.

Mexico). One can hardly imagine a worse signal to the national business community, demonstrating that Maryland is business unfriendly and not competitive.

Historically, most states, including Maryland, have included in their sales tax base a broad range of goods, but only a limited range of services. With the rapid growth of the services sector in recent decades, it is understandable why a state would want to expand its sales tax base to include more service categories. However, H.B. 1628 expands the sales tax base not only to include a wide range of services consumed by households, but also to an even wider range of services consumed by businesses. In recent years, there have been similar broad-based proposals in several states such as Louisiana, Minnesota, and Ohio to significantly expand the sales tax to include services, and the share of the additional tax that would be imposed on business inputs was estimated to be as high as 80%.[2] The disproportionate burden that would be imposed on businesses by H.B. 1628 has been acknowledged by the Maryland Department of Legislative Services. In its Fiscal and Policy Note on H.B. 1628, the Department reached the following conclusion: "It should be noted that many of the categories of services that are estimated to generate significant revenue under the bill, including business services, professional services, and information services, are services that are largely consumed by businesses."[3]

The Maryland Department of Legislative Services also noted the historic failure of all other sales tax base broadening proposals that included a wide range of business services, compared with the more incremental approach taken by many other states that limited the base expansion largely to services purchased by households: "A number of states, including Louisiana, Massachusetts, Michigan, Nebraska, Pennsylvania, and Utah, have proposed significantly broadening their sales tax bases, including to professional services, but none have been successful. Meanwhile, Connecticut, the District of Columbia, Iowa, Kentucky, and North Carolina have taken incremental steps to broaden the application of their sales and use taxes to additional services."[4]

Maryland would do well to heed the lessons of other state efforts to broaden the sales tax base and limit the expansion to household services only. To do otherwise, will encumber the State with a draconian expansion of the sales tax base to business inputs and make Maryland an outlier among all states in terms of its divergence from the principles of a fair and efficient sales tax. This, in turn, will undermine all of the State's efforts to raise revenues for state and local government programs while still fostering a healthy environment for business investment and job growth. While we understand that the legislative intent of H.B. 1628 is to broaden the base and lower the sales tax rate, the proposed rate reduction does not mitigate COST's concerns regarding the expansion of the tax base to business-to-business transactions.[5]

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an

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[2] Cline, Phillips, Neubig, "What's Wrong with Taxing Business Services? Adverse Effects from Existing and Proposed Sales Taxation of Business Investment and Services," 15-17.
[3] Department of Legislative Services, Maryland General Assembly, "Fiscal and Policy Note" on House Bill 1628, 5, available at: http://mgaleg.maryland.gov/2020RS/fnotes/bil_0008/hb1628.pdf.
[4] *Id.* at 4.
[5] Businesses will certainly benefit from the sales tax rate reduction on the business inputs that are currently taxed under Maryland law. But since the business share of purchased services included in sales tax base broadening legislation is generally much larger than the business share of purchased goods subject to sales tax, H.B. 1628 is likely to lead to a substantial net increase in sales tax paid by businesses in Maryland.

advisory committee to the Council of State Chambers of Commerce and today has an independent membership of approximately 550 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities.

Policy Against Imposing State Sales Tax on Business Inputs

The COST Board of Directors has adopted a formal policy position opposing the imposition of state sales tax on business inputs, which provides.[6]

> *Imposing sales taxes on business inputs violates several tax policy principles and causes significant economic distortions. Taxing business inputs raises production costs and places businesses within a State at a competitive disadvantage to businesses not burdened by such taxes. Taxes on business inputs, including taxes on services purchased by businesses, must be avoided.*

H.B. 1628 is inconsistent with creating a more efficient and modern sales tax system. Imposing sales tax on business inputs specifically violates the tax policy principles of neutrality, equity, simplicity and transparency, and it causes significant economic distortions. Taxing business inputs is inconsistent with the rationale for a sales tax designed to operate as a tax only on final household consumption; because businesses are not the final consumers of business input purchases, the sales tax should not apply to their purchases.[7]

Notably, these distortions result primarily from pyramiding. Pyramiding occurs when a tax is imposed at multiple levels that results in a hidden effective tax rate that exceeds the retail sales tax rate. Pyramiding forces companies to either pass these increased costs on to consumers or reduce their economic activity in the State to remain competitive with other producers who do not bear the burden of such increased taxes. Because of these choices, the economic burden of taxes on business inputs inevitably shifts to labor in the State (through lower wages and employment) or consumers (through higher prices).

H.B. 1628 would create other significant adverse economic distortions from the current taxation of business purchases in Maryland. For example:

- Taxing business inputs encourages companies to self-provide business services to avoid the tax rather than purchasing them from more efficient providers and paying tax (vertical integration);

- Taxing business inputs places companies selling in international, national and regional markets at a competitive disadvantage to many of their competitors, leading to a reduction in investment and employment in the State;

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[6] Available at: https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-of-business-inputs.pdf.

[7] Andrew Phillips and Muath Ibaid, Ernst & Young LLP, "The Impact of Imposing Sales Taxes on Business Inputs," prepared for the State Tax Research Institute and the Council On State Taxation (May 2019), available at: https://www.cost.org/globalassets/cost/stri/studies-and-reports/1903-3073001_cost-ey-sales-tax-on-business-inputs-study_final-5-16.pdf.

- Taxing business inputs unfairly and inefficiently taxes some products and services more than others by imposing varying degrees of tax on inputs in addition to a general tax rate on final sales;

- Taxing business inputs unfairly hides the true cost of government services by embedding a portion of the sales tax in the final price of goods and services; and

- Taxing business inputs increases administrative and compliance costs for tax administrators and taxpayers.

Finally, sales taxes on business services, in particular, create significant cost disadvantages for small businesses. Small businesses are often less likely than large businesses to be able to vertically integrate. Without the means to compete with larger businesses that can vertically integrate and internalize certain costs, the demand for services provided by small businesses is reduced. Moreover, increased administrative and compliance costs are another strain for small businesses to absorb.

H.B. 1628 Would Undo Much of the Benefit of Maryland's Legislative Shift to a Single Sales Factor

Ironically, Maryland's recent tax policy has moved in a diametrically opposite direction with regard to understanding the importance of providing a tax structure that encourages in-state production and investment. For corporate income tax purposes, Maryland has recognized the value of relying on consumption rather than production tax principles as a central tenet of sound tax policy by shifting the apportionment formula for its corporate net income tax to rely almost wholly on the sales factor. By removing the property and payroll factors from the corporate apportionment formula, Maryland is taxing businesses not based on the jobs or investment in the State, but only based on their proportion of sales into the State. To then turn around and enact sweeping sales tax base broadening legislation, the burden of which will fall largely on businesses, will move Maryland in the exact opposite direction, penalizing businesses for investing, making purchases, and creating jobs in Maryland.

H.B. 1628 Would Negatively Impact Maryland's Sales Tax Scorecard Grade

In April 2018, COST released a Scorecard evaluating "The Best and Worst of State Sales Tax Systems."[8] The Sales Tax Scorecard graded states on the administration of their respective state and local sales and use taxes. Like other COST scorecards, it is meant to help improve tax administrative systems which will ultimately increase compliance. The Sales Tax Scorecard objectively evaluates state statutes and administrative rules that govern the administrations of the states' sales taxes by the states' taxing agencies. COST's scorecards are ultimately directed at policymakers, who are in the best position to make improvements to the state's sales tax through statutory changes. In the Sales Tax Scorecard, COST considered the following categories:

- The extent of taxation of business inputs or pyramiding of the sales taxes;

- Fair sales tax administrative practices;

[8] Available at: https://cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/the-best-and-worst-of-state-sales-tax-systems-august-17-2018-final.pdf.

- Uniformity of state and local sales tax bases and centralized administration;
- Simplification and transparency of the sales tax;
- Reasonable tax payment and credit administration; and
- Fair audit and refund procedures.

Considering these categories, Maryland received a "C" grade. If H.B. 1628 passed, however, Maryland's grade would definitely be impacted adversely. Specifically, its grade would likely be lowered to a "D+," significantly lowering its ranking amongst the other states to become one of the lowest ranked states. H.B. 1628 would directly impact Maryland's score in the categories evaluating the taxation of business inputs and pyramiding of the sales tax. H.B. 1628 will significantly increase Maryland's percentage of state and local sales tax derived from business-to-business transactions, which currently is estimated at 42 percent. By way of comparison, South Dakota and New Mexico, two of the states that tax the broadest range of services (without exemptions for business inputs), also have the highest share of state and local sales taxes derived from taxing business inputs at 58 percent and 60 percent, respectively.

For these reasons, COST urges members of the Committee to please vote "no" on H.B. 1628.

Respectfully,

Stephanie T. Do

cc: COST Board of Directors
Douglas L. Lindholm, COST President & Executive Director